
Risk Management and Insurance

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*To Steve, Dalit, Liat, Aviva, Josh, Jeremy, and
Timy, for their patience and support.*

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Cover Image © *PhotoDisc, Inc.*

This book was set in Minion and was printed and bound by R. R. Donnelly & Sons. The cover was printed by Lehigh Press.

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ISBN 0-471-27087-3

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

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PREFACE

INTRODUCTION AND BACKGROUND

This textbook, designed to reflect the dynamic nature of the field of risk management and insurance, serves as an introduction to the field. This is a comprehensive revision of the seventh edition of *Risk Management and Insurance*, by S. Travis Prichett, Joan T. Schmit, Helen I. Doerpinghaus, and the late James L. Athearn. It includes new pedagogical enhancements, as well as discussion of new products, laws, conditions, and technologies in the field.

In the first years of this century, the terrorist attacks on the World Trade Center and the Pentagon and the accounting scandals of Enron and WorldCom all highlighted the importance of risk management and insurance. Giving particular attention to the market's increased sense of vulnerability and the newest technologies, *Risk Management and Insurance* provides a clear introduction to the complexities of this field. With chapters including topics such as e-risks and enterprise risk, EGTRRA 2001, loss development triangles, the health insurance evolution, the newest property/casualty endorsements, and a focus on connecting each chapter to the bigger picture, the objective is to show students how the latest developments and the field's traditional approaches fit together into holistic risk management.

In both the areas of property/casualty and life/health, the newest products, laws, and applications are explained in simple terms to allow hands-on learning. To this end, sample policies, examples, and cases are provided.

The objective of this revision is to retain the strengths of the previous edition while enhancing the pedagogical methods with new and updated areas relevant to the field of risk and insurance today. The clarity and simplicity of the previous text with its operational emphasis is maintained.

TEXT ORGANIZATION

- **An emphasis on the big picture—the Connection section.** The insurance industry, operations, and markets have been brought to the front of the book to clarify the “big picture” for students. Risk and insurance can appear to be a complex puzzle composed of many pieces. In addition to the early overview of industry, operations and markets, a “Connection” section begins each chapter to highlight the relationships between various concepts and components of risk and insurance, so that students know how the pieces fit together.
- **Chapter 3 presents current risk management practices, including enterprise risk management.** The chapter moves from traditional risk management through risk mapping to enterprise risk management, including the use of the capital markets and cat bonds. Chapter 3 can be used to introduce risk

management or for advanced study. Out of the cases at the end of the text, two are particularly relevant to this chapter: Case 3 provides advanced risk management tools for a large corporation, and Case 4 experiments with the financial risk management tools described in Chapter 3.

- **Chapter 4 contains a review of insurance company operations and loss development techniques.** The chapter includes an actuarial loss development triangle technique for loss reserves and rate calculations. Understanding this process of estimating future losses based on past losses is at the heart of insurance operations. Students who understand how insurance companies deal with losses will understand the underlying dynamic of the industry. Thus, the up-front study of the loss development technique in this chapter is part of a conceptual framework that will help students learn the details of insurance that are covered later in the text.
- **Chapter 5 contains a review of insurance markets, underwriting cycles, regulated and unregulated markets, and regulation.** The chapter is designed to furnish an understanding of the global operations of insurance markets, so student can appreciate the importance of market conditions (and the underwriting cycles) on risk management decisions. The types of insurance institutions and the U.S. insurance regulation today are discussed, including the most recent updates. The chapter incorporates the insurance implications of the Gramm-Leach-Bliley (GLBA) Financial Services Modernization Act of November 12, 1999.
- **E-Commerce Risk:** This emerging and evolving risk is covered in detail in Chapters 8, which is devoted to property risk in general, and in Chapter 9, which is centered around liability risks.
- **Employee benefits and individual life/health products:** all new laws are incorporated, including EGTRRA 2001, along with case examples of a dental office for pensions, comparative matrices for group health insurance and group underwriting, and rate quotes and policy features for individual health policies (in Chapter 19.) This area is supplemented with Case 2, an employee benefits portfolio for a hypothetical company.
- **Social Security:** The chapter is updated with the most recent year's data (2003). All data will be kept current on the text's Web site.
- **Case studies:** The book begins with an introductory case on the losses of September 11, 2001, and concludes with a section featuring comprehensive cases in risk management and insurance for personal needs and business needs. These cases help students recognize the relevancy and applications of the book's concepts in the real world.
 - **Introduction with cases:** The introduction provides an overview of all the elements of the textbook, using the huge losses of September 11 as a first glimpse into the field. Two victim families are featured, and the insurance coverages discussed include the United States' social insurance programs, employer provided employee benefits, and private insurance. Also, one business that sustained losses during September 11 is featured, and this raises discussion of business interruption coverage.
 - **Conclusion with case studies:** To complete the "big picture" of holistic risk for a family with hand-on application, Case 1 features the hypothetical Smith family and their risk management portfolio. To complete the

understanding of the employee benefits packages offered by employers, Case 2 is featured. Cases 3 and 4 are for more advanced risk management techniques to augment Chapter 3.

NEW FEATURES

- **Important Issues:** Each chapter is filled with current real-life examples to liven up the study for the student and to clearly show the application of concepts of risks in our everyday lives. Important Issues boxes include discussions on topics such as punitive damages, mortality improvements, recent laws affecting health care, auto rates, business interruption issues, mold, and more.
- **Explore the Internet:** At the conclusion of each “Important Issues” box, the reader is directed to use Web sites applicable to the chapter and the stories. Within each chapter there are many references to Internet sites the student can use for additional information and updates.
- **Ethical Dilemma:** Each chapter features an “Ethical Dilemma” that deals with current issues such as the Federal terrorism insurance bill, redlining, obesity and lawsuits, the conversion of traditional defined benefit plans to cash balance pension plans, and the tradeoff between health care cost and benefits. At the conclusion of each story, questions are provided to prompt related discussion.
- **The newest sample personal and commercial property/casualty ISO policies** are discussed in detail along with the most up-to-date ISO sample endorsements for terrorism, e-commerce and mold coverages. Hands-on-examples using the policies encourage students to truly understand the workings of these policies.
- **New sample life insurance policies from State Farm** are furnished, along with a thorough explanation, to give a clear understanding of the coverages and life products available in the market place today.
- **Student-friendly:** A clear, readable writing style helps to keep a complicated subject from becoming overwhelming. In-chapters examples and the “Ethical Dilemmas” and “Important Issues” let students apply the concepts they’re learning.
- **New Discussion Questions and Exercises at the end of each chapter:** Many new questions and case exercises were added to provide more challenging applications to the students and encourage the use of the policies provided at the back of the text.

SUPPLEMENTS

Instructors’ Resources

All teaching supplements will be available for instructors to download from the password-protected Instructors’ Companion Web Site, at www.wiley.com/college/baranoff.

Instructor’s Manual

This guide for instructors begins with suggestions on how to use the textbook to teach different levels of students, from beginning to intermediate. Specific tips are given in each chapter for the various levels. Each chapter has an orientation, complete outline,

and answers to all discussion questions and exercises. In providing answers, we have included matrices for the comparison questions and spreadsheets for the more quantitative exercises.

Test Bank

The test bank consists of 30 multiple choice questions and 5 or more short answer questions for each chapter. Key concepts are emphasized throughout, with questions offered at a range of difficulty levels.

PowerPoint Presentations

PowerPoint slides provided for each chapter present key exhibits and outlines of the critical topics in each chapter.

Student Resources

The students' Web site, www.wiley.com/college/baranoff, will furnish current reading and exercises, including updates to the Important Issues and Ethical Dilemma boxes.

ACKNOWLEDGEMENTS

This book lists one author, but it is based on the 1996 edition of the text book *Risk Management and Insurance* (seventh edition) by S. Travis Prichett, Joan T. Schmit, Helen I. Doerpinghaus and the late James L. Athearn. Their textbook is the foundation of this text. Without this foundation and their recommendation that I undertake the overhauling of their book, I would not have accepted this large project.

My publisher, Leyh Publishing, provided extensive and excellent support in completing this work. Rick Leyh's excellent suggestions and support have been critical to my work. Rick has provided superb leadership in this undertaking. In addition, Lari Bishop, Kris Pauls and Camille McMorrow kept the production and development work on target. The Wiley team, including Susan Elbe, Publisher, Leslie Kraham, Acquisitions Editor, and Charity Robey, Senior Marketing Manager, was very supportive. Most important to me was the exceptional work of my copyeditor and author of the Important Issues and some of the Ethical Dilemma boxes, Christy Goldfinch. Christy has been more than a copyeditor. She studied each topic and provided excellent questions and suggestions while ensuring the simplicity and clarity of the text. Many thanks also to my daughter, Dalit Baranoff, for her fine work on the test bank and the Ethical Dilemma boxes for Chapters 10 through 19, as well as for her support and additional suggestions as I wrote each chapter.

I would like to give special tribute and acknowledgment to all my students in my Risk and Insurance and Employee Benefits classes at Virginia Commonwealth University for their excellent work on projects similar to those featured in Cases 1 and 2. Special recognition is given to Jessica Duke, a Spring 2002 student, who provided much of the research and support for the e-commerce risk sections and the updates to the Social Security chapter. Most important is the work of my graduate student Denise Togger, who wrote Case 4 as a special studies project and contributed large sections of Chapter 3.

In addition, important suggestions were made by a number of colleagues who took their time to offer detailed comments on the book before its final revision. These reviewers include:

Joan Lamm-Tennant, GeneralCologne Re Capital Consultants

Dan Anderson, University of Wisconsin at Madison
Dalit Baranoff, Johns Hopkins University
Cassandra Cole, Florida State University
Lee Colquitt, Auburn University
Anne Costello, University of Hartford
Mark Cross, Miami University of Ohio
Alan D. Eastman, Indiana University of Pennsylvania
Karen Epermanis, University of Mississippi
George Flanigan, Illinois State University
Lisa A. Gardner, Bradley University
Michael J. McNamara, Washington State University
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Dr. Etti G. Baranoff is an associate professor of insurance and finance at Virginia Commonwealth University in Richmond, VA. She teaches insurance, pensions, employee benefits, and finance topics to graduate and undergraduate classes. Prior to her academic career, Dr. Baranoff was a Texas insurance regulator for 12 years with specialty in rate regulation, solvency studies, and modeling and legislative issues. Her career also includes experience with a life insurer, a Texas public risk pool, and consulting. Dr. Baranoff has spoken in many insurance forms and has published in the *Journal of Risk and Insurance*, the *Journal of Banking and Finance*, the *Journal of Insurance Regulation*, and *Best's Review*, among others. Her research subjects include solvency detection models, capital and risk relationship, capital, risk, organization and distribution structures relationships, risk financing, impact of insurance regulation, and risk management information systems. She received her Ph.D. in finance with minors in insurance and statistics from the University of Texas at Austin in 1993. She lives in Austin and commutes to teach at VCU. Dr. Baranoff can be contacted at: ebaranof@vcu.edu.

Chapters 3-4: Introduction to Risk Management and Insurance. — Risk management: A scientific approach to handling risks by anticipating possible losses and designing and implementing procedures that minimize the occurrence of loss or the financial impact of the losses that do occur — a process which attempts to minimize the cost of loss. Objectives of Risk Management. — Risk management has objectives before and after a loss occurs — Pre-loss objectives: - Prepare for potential losses in the most economical way - Reduction of anxiety - continue operating — Post-loss objectives (in order or imposable): Strategic risks in insurance. The potential for companies and industries to be disrupted and perhaps even displaced by transformational trends in technology, the economy, and consumer preferences is on the rise in today's rapidly evolving, increasingly digitized economy. Insurance is facing such strategic risks — emerging threats that can undermine the core assumptions of a company's value proposition and operations. Unlike most other industries, risk management is already a core function of insurance companies and many carriers have already adopted enterprise risk management (ERM). Following The Risk Management Process. Understanding The Risk Manager's Role. Exploring Underwriting Decision Making. Making Auto, Property, and Liability Underwriting Decisions. Making Claims Decisions. Handling Bodily Injury and Property Damages Claims. Course Level. (New). — Select the program path that matches your career goals and gain foundational knowledge in risk management and insurance. Learn More about Associate in General Insurance. Designation. Most Popular. . CPCU. . Gain confidence and make better business decisions through a broad understanding of risk management and insurance. Learn More about CPCU. The Institutes.